No. 8166

In the United States Circuit Court of Appeals

For the Ninth Circuit.

Pacific Employers Insurance Company,
Appellant.

vs.

Commissioner of Internal Revenue,
Respondent.

BRIEF FOR THE APPELLANT.

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BRIEF FOR THE APPELLANT.

STATEMENT OF THE CASE.

Questions Involved and How Raised.

This case comes before this Court on a petition to review a decision by the United States Board of Tax Appeals (hereinafter referred to for brevity as the "Board") sustaining the Commissioner in the determination of an income tax deficiency against appellant in the amount of $1,193.45 for the taxable year 1930.

The proceedings before the Board arose under a petition and amended petition filed by the appellant for redetermination of the deficiency proposed by the Commissioner. The decision by the Board is reported at 33 B. T. A. 501.

The appellant is an insurance company other than a life or mutual company and the determination of its income and tax for the year 1930 is governed by the provisions of section 204, Revenue Act of 1928. Upon its return for 1930, appellant claimed a deduction of $882,-632.55 for "losses incurred," determined upon a "case claims method" under which the "unpaid loss" on each claim was estimated on the basis of all known facts. This deduction of $882,632.55 has been allowed by respondent and by the Board.

The appellant contends that it is entitled to a deduction of $1,022,015.88 for "losses incurred" determined upon the basis of the "Underwriting and Investment Exhibit" contained in the "Annual Statement Approved by the National Convention of Insurance Commissioners", referred to in section 204(b) (1), Revenue Act of 1928, which was filed with the Insurance Commissioner of California. The deduction for "losses incurred" under this exhibit was computed in accordance with the laws of California, under which appellant operated.

There is no issue on the facts and the question is purely one of statutory interpretation. If Congress intended that the deduction for "losses incurred" should be determined on the basis of the "underwriting and investment exhibit", then it is agreed the appellant has made an overpayment of $1,212.24. If the deduction for "losses incurred" is to be determined without regard to said exhibit, then it is agreed that the deficiency proposed by the respondent and approved by the Board is correct.

All of the facts in the case were presented in a stipulated statement of facts and exhibits thereto attached [Tr. 20-32].

Statement of Facts.

Appellant is an insurance company "other than life or mutual", as described in section 204, Revenue Act of 1928, and its income taxes for the year 1930, here in question, are to be determined under the provisions of that section. [Tr. 20-21.] The appellant was incorporated under the laws of the state of California on July 26, 1923, and its business is confined solely to, and is regulated solely by the laws of, the state of California. [Tr. 21.] The principal business written by the appellant is Workmen's Compensation Insurance and approximately fourteen-fifteenths of its net premium income during 1930 was from this source. [Tr. 22.] The balance of its premium income for 1930 was from automobile liability, collision and property damage insurance, and public liability and theft insurance. [Tr. 22.]

On its return for 1930, the appellant claimed a deduction of $882,632.55 for "losses incurred", determined as follows [Tr. 22]:

"Losses paid		$865,801.55
End (losses unpaid at end of 1930) 1930	$660,980.00	
End (losses unpaid at end of 1929) 1929	644,149 00	16,831.00
Losses Incurred		$882,632.55"

The amounts for "losses unpaid" at the end of 1929 and 1930, respectively, were determined as the result of a calculation based on the claims filed with the appellant and represented the sums which the company's examiner believed the appellant would be required to pay. [Tr. 38-39.]

With its income tax return, appellant filed a copy of a portion of its "Annual Statement for the Year Ending December 31, 1930, of the Condition and Affairs of the Pacific Employers Insurance Company" on the form "Miscellaneous Stock Companies—Convention Edition 1930." [Tr. 24-25.] Said statement was the "Annual Statement Approved by the National Convention of Insurance Commissioners" referred to in subparagraph (b) (1) of section 204, Revenue Act of 1928. [Tr. 25.]

On page 8 of said statement, the following facts and figures were set forth with respect to the premiums and losses for the year 1930 [Tr. 30]:

"Premiums

1.	Total premiums, per item 20, page 2	$1,598,789.27	
2.	Add unearned premiums and additional reserve December 31 of previous year, per item 8 of last year's exhibit	178,644.32	
3.	Total	$1,777,433.59	
4.	Deduct unearned premiums and additional reserve Dec. 31 of current year, per items 25 and 25½ page 5	170,936.00	
5.	Premiums earned during the year		$1,606,470.59

Losses

6.	Losses paid, per item 17, page 3	$ 872,735.74
7.	Add salvage and reinsurance recoverable December 31 of previous year, per item 13 of last year's exhibit	12,489.31
8.	Total	$885,225.05
9.	Deduct salvage and reinsurance recoverable December 31 of current year, per items (a) 42, page 4	19,423.50
10.	Balance	$ 865,801.55
11.	Add unpaid losses December 31 of current year, per item 19, page 5	596,532.85
12.	Total	$1,462,334.40
13.	Deduct unpaid losses December 31 of previous year, per item 15 of last year's exhibit	440,318.52
14.	Losses incurred during the year	$1,022,015.88

"

The items of unpaid losses appearing in said statement were computed in accordance with the provisions of section 602(a) of the Political Code of California, which law governs the business of petitioner. [Tr. 25-26.] The unpaid loss items set forth in said statement represent the highest aggregate reserve, after deduction for reinsurance, called for at the beginning and end of the taxable year by said law of the state of California and they represent sums actually held by appellant, as shown by the annual statement. [Tr. 26.]

Specification of Errors.

The appellant, in its petition for review [Tr. 45-46] made the following assignments of errors upon which it relies in this appeal:

1. The Board erred as a matter of law in ordering and deciding that there was a deficiency for the year 1930.

2. The Board erred as a matter of law in failing and refusing to determine that appellant had made an overpayment of $1,212.24 for the year 1930.

3. The Board erred in its decision and determination as a conclusion of law that appellant was not entitled to a deduction of $1,022,015.88 for "losses incurred" during the year 1930, as defined in section 204 (b), Revenue Act of 1928.

4. The Board erred in its decision and determination as a conclusion of law that the "unpaid losses" of appellant outstanding at the end of the preceding taxable year (1929), as defined in section 204 (b), Revenue Act of 1928, was not $440,318.52.

5. The Board erred in its decision and determination as a conclusion of law that the "unpaid losses" of appellant outstanding at the end of the taxable year 1930, as defined in section 204 (b), Revenue Act of 1928, was not $596,532.85.

6. The Board erred as a matter of law in its determination that the "losses incurred", as designated in section 204 (b) (4) and (6), Revenue Act of 1928, were not to be "computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners", as expressly provided in section 204 (b) (1), Revenue Act of 1928.

The fundamental issue in the case is whether the deduction for "losses incurred" is to be determined on the basis of the "underwriting exhibit", or whether it is to be determined on some other basis.

Statutes and Regulations.

Section 204, Revenue Act of 1928 (45 Stat. 844), provided as follows:

"SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL

(a) *Imposition of tax.* In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income;

(2) In the case of such a foreign insurance company, 12 per centum of its net income from sources within the United States.

(b) *Definition of income, etc.* In the case of an insurance company subject to the tax imposed by this section—

(1) *Gross income.* 'Gross income' means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioner, and (B) gain during the taxable year from the sale or other disposition of property;

(2) *Net Income.* 'Net income' means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section.

(3) *Investment Income.* 'Investment income' means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) *Underwriting Income.* 'Underwriting income' means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) *Premiums Earned.* 'Premiums earned on insurance contracts during the taxable year' means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) *Losses Incurred* 'Losses incurred' means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) *Expenses Incurred.* 'Expenses incurred' means all expenses shown on annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions allowed.* In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23 (p);

(8) The amount of interest earned during the taxable year which under section 22 (b) (4) is exempt from taxation under this title, and the amount of interest allowed as a credit under section 26;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (k);

(10) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by this section shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(d) *Deductions of foreign corporations.* In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I.

(e) *Double deductions.* Nothing in this section shall be construed to permit the same item to be twice deducted."

Article 992, Regulations 74, pertaining to the Revenue Act of 1928, provided as follows:

"*Art. 992. Gross income of insurance companies other than life or mutual.* Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from sale or other disposition of property. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, gross increase due to adjustments in book value of capital assets, and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Act will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as divi-

dends declared, home office remittances and receipts, and special deposits, are ignored. Gain or loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts or, having been previously charged off, are recovered during the taxable year."

Section 602 (a), Political Code of California, provided as follows:

§ 602a. How Conditions of Company Shall Be Estimated. [Estimate of indebtedness of liability insurance companies.] In estimating the condition of any insurance corporation, mutual company, association, the state compensation insurance fund, interinsurance exchange or other insurance carriers engaged in the business of liability insurance and licensed to transact business in this state, the insurance commissioner shall charge as liabilities, all outstanding indebtedness of such carrier, and the premium reserve on policies in force equal to the unearned portions of the gross premiums charged for covering the risks, computed on each respective risk from the date of the issuance of the policy.

[Computation of reserve.] The reserve for outstanding losses under insurance against loss or damage from accident to or injuries suffered by an employee or other person and for which the insured is liable shall be computed as follows:

(1) [Liability suits.] For all liability suits being defended under policies written more than—

(a) Ten years prior to the date as of which the statement is made, one thousand five hundred dollars for each suit.

(b) Five and less than ten years prior to the date as of which the statement is made, one thousand dollars for each suit.

(c) Three years and less than five years prior to the date as of which the statement is made, eight hundred fifty dollars for each suit.

(2) [Liability policies.] For all liability policies written during the three years immediately preceding the date as of which the statement is made, such reserve shall be sixty per centum of the earned liability premiums of each of such three years less all loss and loss expense payments made under the liability policies written in the corresponding years; but in any event, such reserve shall, for the first of such three years, be not less than seven hundred fifty dollars for each outstanding liability suit on said year's policies.

(3) [Claims under policies written three years prior.] For all compensation claims under policies written more than three years prior to the date as of which the statement is made, the present value at four per centum interest of the determined and the estimated future payments.

(4) [Claims under policies written three years preceding.] For all compensation claims under policies written in the three years immediately preceding the date as of which the statement is made, such reserve shall be seventy per centum of the earned compensation premiums of each of such three years, less all loss and loss expense payments made in connection with such claims under policies writ-

ten in the corresponding years; but in any event in the case of the first year of any such three-year period such reserve shall be not less than the present value at four per centum interest of the determined and the estimated unpaid compensation claims under policies written during such year.

["Earned premiums."] The term "earned premiums," as used herein, shall include gross premiums charged on all policies written, including all determined excess and additional premiums, less return premiums, other than premiums returned to policyholders as dividends, and less reinsurance premiums and premiums on policies cancelled, and less unearned premiums on policies in force.

["Compensation."] The term "compensation" as used in this act, shall relate to all insurance effected by virtue of statutes providing compensation to employees for personal injuries irrespective of fault of the employer. The term "liability" shall relate to all insurance except compensation insurance against loss or damage from accident to or injuries suffered by an employee or other person and for which the insured is liable.

["Loss payments."] The terms "loss payments" and "loss expense payments," as used herein, shall include all payments to claimants, including payments for medical and surgical attendance, legal expenses, salaries and expenses of investigators, adjusters and field men, rents, stationery, telegraph and telephone charges, postage, salaries and expenses of office employees, home office expenses, and all other payments made on account of claims, whether such payments shall be allocated to specific claims or unallocated.

[Distribution of unallocated liability loss expense payments.] All unallocated liability loss expense payments

made in a given calendar year subsequent to the first four years in which an insurer has been issuing liability policies, shall be distributed as follows: Thirty-five per centum shall be charged to the policies written in that year, forty per centum to the policies written in the preceding year, ten per centum to the policies written in the second year preceding, ten per centum to the policies written in the third year preceding, and five per centum to the policies written in the fourth year preceding, and such payments made in each of the first four calendar years in which an insurer issues liability policies shall be distributed as follows: In the first calendar year one hundred per centum shall be charged to the policies written in that year, in the second calendar year fifty per centum shall be charged to the policies written in that year and fifty per centum to the policies written in the preceding year; in the third calendar year forty per centum shall be charged to the policies written in that year, forty percentum to the policies written in the preceding year, and twenty per centum to the policies written in the second year preceding, and in the fourth calendar year thirty-five per centum shall be charged to the policies written in that year, forty per centum to the policies written in the preceding year, fifteen per centum to the policies written in the second year preceding, and ten per centum to the policies written in the third year preceding, and a schedule showing such distribution shall be included in the annual statement.

[Distribution of unallocated compensation loss expense payment.] All unallocated compensation loss expense payments made in a given calendar year subsequent to the first three years in which an insurer has been issuing compensation policies shall be distributed as follows: Forty

per centum shall be charged to the policies written in that year, forty-five per centum to the policies written in the preceding year, ten per centum to the policies written in the second year preceding and five per centum to the policies written in the third year preceding, and such payments made in each of the first three calendar years in which an insurer issues compensation policies shall be distributed as follows: In the first calendar year one hundred per centum shall be charged to the policies written in that year, in the second calendar year fifty per centum shall be charged to the policies written in that year and fifty per centum to the policies written in the preceding year, in the third calendar year forty-five per centum shall be charged to the policies written in that year, forty-five per centum to the policies written in the preceding year and ten per centum to the policies written in the second year preceding, and a schedule showing such distribution shall be included in the annual statement.

[Additional reserves.] Whenever, in the judgment of the insurance commissioner, the liability or compensation loss reserves of any insurer under his supervision, calculated in accordance with the foregoing provisions, are inadequate, he may, in his discretion, require such insurer to maintain additional reserves based upon estimated individual claims or otherwise.

[Schedule of experience.] Each insurer that writes liability or compensation policies shall include in the annual statement required by law a schedule of its experience thereunder in such form as the insurance commissioner may prescribe.

History: Amendment approved June 6, 1913, Stats. and Amdts. 1913, p. 493; amended May 26,

1917, Stats. and Amdts. 1917, p. 1178. In effect July 27, 1917.

Editorial Note: On June 6, 1913, two acts were passed amending § 602a, see Stats. and Amdts. 1913, pp. 465, 493, Kerr's Cumulative Supplement to Cyc. Codes of California, 1906-1913, pp. 65-70, and "editorial" note on pp. 67, 68. From a reading of the two amendments of 1903 it is manifest that the intention of the legislature was to amend the second of the acts passed on June 6, 1913, and which in "Kerr's Cumulative Supplement" and "Kerr's Small Codes of California," is designated as § 602[a]. In case of any doubt consult those works.

Summary of Argument.

Congress has enacted, beginning with the Revenue Act of 1921, special provisions for the taxation of insurance companies other than life or mutual. Section 204 of the Revenue Act of 1928, which governs the year 1930 here in question, contemplates and, we submit, expressly provides that "losses incurred", as pertaining to "underwriting income", shall be computed on the basis of underwriting and investment exhibit of the annual statement on the convention form. The deduction for "losses incurred", as claimed herein by appellant, is the exact amount reflected in said exhibit, whereas the deduction allowed by the respondent and the Board was computed on an entirely different basis.

The regulations and rulings of the Treasury Department have consistently recognized that the deduction for "losses incurred" must be computed on the basis of the underwriting exhibit.

ARGUMENT.

I.

The Law Clearly Provides That the Deduction for "Losses Incurred" Must Be Computed on the Basis of the Underwriting Exhibit, Rather Than on General Principles.

Under the Revenue Act of 1918, insurance companies were taxed as ordinary corporations, except that certain additional deductions were allowed to them. Under the 1921 Act an entirely new scheme was introduced for the taxation of insurance companies. Under this new scheme, three separate groups of insurance companies were recognized and a separate method of taxation was established as to each. With only minor changes this scheme has been followed in subsequent acts, including the Revenue Act of 1928. See 4 Paul and Mertens, Federal Income Taxation, 286 *et seq.*

The new provisions as to insurance companies were first inserted by the Senate in the draft of sections 246 and 247 of the 1921 Act and accepted by the House conferees with the following comments (Conference Report, No. 486, November 19, 1921, page 41):

> "Amendment No. 495: The House bill provided specifically that every insurance company not exempt under the provisions of section 231 shall make a return for the purposes of this act. As section 239 provides that corporations (including insurance companies) subject to taxation under Title II shall make returns, Senate amendment No. 495 strikes out the above provision of the House bill as surplusage and provides a new system of taxing insurance companies (other than life or mutual insurance companies). The

> Senate amendment defines the term 'gross income' of such companies to mean the combined gross amount earned during the taxable year from investment income and from underwriting income computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners. 'Expenses incurred' are defined to mean all expenses shown on the aforementioned annual statement approved by the National Convention of Insurance Commissioners; but for the purpose of computing taxable net income only those expenses specifically allowed may be deducted. The House recedes with an amendment making clerical changes."

The obvious purpose of making this change was to permit insurance companies to determine their taxable income substantially on the same basis as their records were required to be kept under the laws of the various states. Congress recognized that insurance companies (other than life or mutual) were required to file with the states in which they operated annual statements in a precise form established for the purpose of uniformity, by the National Convention of Insurance Commissioners. Accordingly, Congress expressly provided in section 204 (b) (1) of the 1928 Act (as in the corresponding Section 246 of the 1921 Act) that:

> " 'Gross income' means the sums of (A) the combined gross amount earned during the taxable year, from investment income and from *underwriting income* as provided in this subsection, *computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Con-*

> *vention of Insurance Commissioners* and (B) gain during the taxable year from the sale or other disposition of property". (Italics supplied throughout this brief.)

Under the above provision, it is clear that "underwriting income" must be computed on the basis of the underwriting exhibit of the annual statement. Subsection (b) (4) then provides that:

> " 'Underwriting income' means the premiums earned on insurance contracts during the taxable year less *losses incurred* and expenses incurred;"

Subsection (b) (6) defines the term "losses incurred" as follows:

> " 'Losses incurred' means losses incurred during the taxable year on insurance contracts, computed as follows:
>
> "To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all *unpaid losses* outstanding at the end of the taxable year and deduct *unpaid losses* outstanding at the end of the preceding taxable year;"

Similarly, subsection (b) (3) defines the term "investment income" and subsection (b) (5) defines the term "premiums paid." Thus there is in section 204 (b) a series of definitions, all of which relate back to the provision "computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners."

If these "losses incurred" were considered as in the nature of "expenses incurred" they would be governed by the provisions of subsection (b) (7) in part as follows:

> "'Expenses incurred' means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners * * *"

An examination of all the provisions of section 204 will demonstrate how carefully Congress provided that the taxable net income, in so far as it related to "underwriting and investment income" should follow the annual statement. The exceptions are as clearly stated in subsection (b) (1) (B) and subsection (c) of section 204. It will be noted that no exception was made with respect to "losses incurred."

That Congress in its draft of section 204 (b) was following very closely the terms and language used in the "underwriting and investment exhibit" form is apparent from a comparison of the statutory definition of "losses incurred" with the corresponding terms on the exhibit [Tr. 30], as follows:

Underwriting and Investment Exhibit	Section 240 (b) (6)
6. Losses paid, per item 17, page 3	"Losses paid during the taxable year"
7. Add salvage and reinsurance recoverable December 31 of previous year, per item 13 of last year's exhibit	"add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year"

9. Deduct salvage and reinsurance recoverable December 31 of current year, per items (a) . . . page 4	"deduct salvage and reinsurance recoverable outstanding at the end of the taxable year."
10. Balance	"To the result so obtained"
11. Add unpaid losses December 31 of current year, per item 19, page 5	"add all unpaid losses outstanding at the end of the taxable year."
13. Deduct unpaid losses December 31 of previous year, per item 15 of last year's exhibit	"deduct unpaid losses outstanding at the end of the preceding taxable year."
14. Losses incurred during the year	"Losses incurred"

It is difficult to see how Congress could have expressed more clearly its intention that the term "losses incurred" in the computation of an insurance company's "underwriting income" should be identical with the "losses incurred" as shown on the convention form of the company's annual statement. Where a statute employs terms which have an established meaning in a trade or business, it is reasonable to assume that the legislative body intended the adoption of that meaning; and this is particularly true where the law expressly refers to a form which uses the terms.

Congress, in establishing a special method of taxation of insurance companies, clearly intended that the "taxable income" from insurance sources should be synonymous with the "underwriting income" on the books of the companies as reflected in the annual statements made to the

insurance commissioners. The appellant herein was required by the state of California to keep its records and determine its "underwriting income" and "losses incurred" in a special manner. Congress has provided in section 204 that the "underwriting income" so computed should be the amount subjected to the tax.

The only authority cited in the Board's opinion is *Ocean Accident & Guarantee Corporation, Ltd. v. Commissioner,* 47 Fed. (2d) 582. However, that case arose under the 1918 Act which did not contain the provisions here in question. The primary issue there involved was whether a double deduction was allowable. A secondary question was whether the estimates were certain enough to justify an allowance. In that connection the court said in part:

> "This brings us to the question whether the deduction claimed by petitioner was an 'accrued' loss. It was an aggregate of estimates of policy losses likely to be suffered on account of all accidents or injuries reported to petitioner during the taxable year. As to some cases, the petitioner may have admitted liability in the amount of the estimate set up on its record card, and so might come within the terms of Article III of Regulations No. 45 as to a deductible loss under clause (4) of section 234 (a). But most of the estimates of liability were not of that character. Each one, viewed alone, would be too contingent as to payment and too uncertain as to amount to be deductible as a 'loss sustained.' Lucas v. Am. Code Co., 280 U. S. 445, 50 S. Ct. 202, 203, 74 L. Ed. 538. But the question is whether the aggregate of estimated unpaid losses for any year may not be taken as an aggregate of accrued losses, though each one separately, or at least most of them, would be contingent and unpredictable. The business of insurance pre-

> supposes that the insurer is able to treat as accurately computable and predictable an aggregate of variables no one of which is either computable or predictable. Without that the business must fail, and only past experience permits any estimate as to the extent to which the variations cancel each other. But the business does go on and with a certainty greater than most others. Here the accrued losses were predictable with remarkable accuracy, the business of petitioner being large enough to disregard the contingencies inherent in each loss taken alone. To assimilate such a situation to a single loss is, in our opinion, to close one's eyes to the substance of the business * * *"

Likewise in the present case the deductions for "unpaid losses" were estimated on the basis of past experience and were based on the aggregate, rather than individual losses. This method was required under the California law and, as recognized by the court in the quotation above, was fair and reasonable and truly reflected the annual income. It may be admitted that Congress *could* have required a stricter determination of each individual loss as it did for other types of corporations; the fact remains, however, that Congress preferred to tax insurance companies on the basis of their regular method of accounting, even though peculiar to that business.

Since the respondent has stipulated that upon the basis of the "underwriting and investment exhibit", the amount of "losses incurred" was $1,022,015.88 [Tr. 24-26] and the law expressly requires that exhibit to be followed, the Board clearly erred in allowing a lesser deduction computed under a method not prescribed in the law.

II.

The Regulations and Rulings of the Treasury Department Have Consistently Interpreted the Law as Contended for by Appellant Herein.

As set forth above, we believe the law is clear and unambiguous in requiring that the "underwriting and investment exhibit" be followed in the determination of the deduction for "losses incurred." However, if there were any ambiguity, it should be resolved in favor of the consistent interpretation of the Treasury Department to the same effect.

In the Revenue Acts of 1921, 1924, 1926 and 1928, Congress promulgated practically identical provisions for the taxation of "insurance companies other than life or mutual." Article 692, Regulations 62, in connection with the 1921 Act contained the express provision that:

> "The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the statute will be recognized and used as a basis for that purpose."

Identical statements are contained in Art. 692, Reg. 65 (1924 Act); Art. 692, Reg. 69 (1926 Act); and Art. 992, Reg. 74 (1928 Act).

Under these regulations the exhibit is presumed to reflect the true *net* income except to the extent inconsistent with the statute. The purpose of the exception is ex-

plained in the following sentences of the regulations, such as:

> "All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits, are ignored."

However, in so far as the item of "losses incurred" is concerned, there is absolutely no inconsistency between the exhibit and the provisions of the statute.

We submit that the regulations represent a reasonable interpretation of the law and in view of the continued reenactment of the same provisions by Congress, that interpretation should prevail. See *Morrissey v. Commissioner,* 80 Law. ed. 245, 251; *Brewster v. Gage,* 280 U. S. 327.

Specific rulings by the Department likewise bear out this interpretation. In I. T. 2665, XI-2 C. B. 134, the Bureau issued the following ruling concerning the Revenue Act of 1921, 1924, 1926 and 1928, and particularly in connection with section 204 and article 992:

> "All insurance companies are *required* to use the highest aggregate reserve, after deduction for reinsurance placed with both authorized and unauthorized companies, called for at the beginning and end of the taxable year by any state in which they transact business, but the reserve must have been actually held as shown by the annual statement approved by the National Convention of Insurance Commissioners."

It will be noted that the above ruling is not permissive but mandatory. It is interesting to compare its requirements with the following statement in the stipulation of facts [Tr. 26]:

> "That Section 602 (a) of the Political Code of California is the law governing the business of petitioner and the unpaid loss items set forth in said Annual Statement (Exhibit 4) represent the highest Aggregate Reserve, after deduction for reinsurance, called for at the beginning and end of the taxable year by said law of said State of California. That said unpaid losses represent sums which have been actually held by petitioner, as shown by said Annual Statement (Exhibit 4)."

There can be no quesiton but that the deduction herein claimed was required to be used by the appellant, under I. T. 2665. Inasmuch as that ruling has never been revoked, it is impossible to reconcile the position taken by the Government in the instant case.

In G. C. M. 2318, VI-2 C. B. 80, the General Counsel had under consideration a question relating to the proper method of determining the allowance for "losses incurred" in the case of insurance companies. We consider this opinion so clear and convincing in its analysis of the law and the interpretation of the provisions here in question that we are reprinting it in *Appendix A*, herein. We believe a study of this General Counsel's opinion by this Court will remove any doubts which they might otherwise have on the question. After quoting the statutory definitions, the General Counsel said in part:

> "This definition of the term 'losses incurred' on the part of Congress is strongly indicative of an inten-

tion on its part to use the term in a sense different from that in which it is ordinarily used. Furthermore, a reference to the 'Underwriting exhibit' (page 10) of the annual statement of fire insurance companies, convention edition, will disclose that 'losses incurred' for the purposes of that statement are determined by the following computation:

* * * * * * * * *

"It will be noted that this computation follows exactly the computation provided by Congress (Sec. 246 (b) (6) *supra*) for determining 'losses incurred' under Section 246 (b) (4). It will also be noted that in item 21, *supra,* entitled 'Unpaid losses December 31, 1922' item 14, page 5, of the annual statement is incorporated by reference. A reference to this item will disclose that it carries the total of 'net unpaid claims' as of the close of the year and includes in that total the total of the two items 'losses incurred but not reported' and 'resisted losses.'

* * * * * * * * *

"It is fundamental that in construing a statute dealing with a particular trade or business it is to be presumed that terms used in such a statute are used in the sense that those terms are understood in trade or business with respect to which the statute was enacted when such terms have a meaning in that trade or business different from the commonly accepted meaning. In view of this rule of statutory construction and the intention of Congress, apparent from a reading of those paragraphs of section 246 hereinbefore quoted, as well as the uniform treatment among fire insurance companies of the items in ques-

> tion as shown by the annual statements of such companies, this office is of the opinion that 'losses incurred but not reported' and 'resisted losses' should be included in the computation of 'losses incurred' under section 246 (b) 4 of the Revenue Act of 1921 and the corresponding sections of subsequent Revenue Acts."

Thus, the regulations and published rulings of the Treasury Department recognize clearly the intention of Congress to follow the amounts shown on the underwriting exhibit of the annual statement of a company, with respect to such technical terms as "losses incurred" and "losses unpaid." We submit that this interpretation should be followed by this Court, for reasons stated by the Supreme Court in *McCaughn v. Hershey Chocolate Co.,* 283 U. S. 488, 492-3, in part as follows:

> "Such a construction of a doubtful or ambiguous statute by officials charged with its administration will not be judicially disturbed except for reasons of weight, which this record does not present. See Brewster v. Gage, 280 U. S. 327, 336; Universal Battery Co. v. United States, 281 U. S. 580, 583; Fawcus Mach. Co. v. United States, 282 U. S. 375, 378. The reenactment of the statute by Congress, as well as the failure to amend it in the face of the consistent administrative construction, is at least persuasive of a legislative recognition and approval of the statute as construed. See *National Lead Co. v. United States,* 252 U. S. 140, 146. We see no reason for rejecting that construction."

Likewise, the record in the present case presents no "reasons of weight" justifying a reversal of the practical interpretation of these provisions by the Department.

Conclusion.

We respectfully submit that whether considered as an original question of interpreting the express provisions of the law or considered on the basis of the practical interpretation by the Treasury Department, the deduction for "losses incurred" must be computed on the basis of the underwriting exhibit of the annual statement, as contended by appellants. Accordingly, the Board's decision was erroneous and contrary to law, and should be reversed.

Respectfully,

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APPENDIX A.

SECTIONS 246 AND 247.

Article 693: Deductions allowed insurance companies. VI-49-3526 G. C. M. 2318

Revenue Acts of 1921, 1924, and 1926.

"Losses incurred but not reported" and "resisted losses" are not allowable as deductions under section 247 (a) 4 of the Revenue Acts of 1921, 1924, and 1926, but such items should be included in the computation of "losses incurred" under section 246 (b) of the Acts mentioned.

An opinion is requested whether "losses incurred but not reported" and "resisted losses" should be allowed fire insurance companies as a deduction under section 247 (a) 4 of the Revenue Acts of 1921, 1924, and 1926, or whether these items are to be included as "losses incurred" under section 246 (b) 4 of the Acts mentioned.

In consideration of the question it should be borne in mind that Congress has, in the Revenue Act of 1921, as well as in the subsequent Revenue Acts, made special provision for the taxation of insurance companies. With respect to insurance companies, other than life or mtual insurance companies, the taxes imposed by section 246 of the Revenue Act of 1921 and subsequent Revenue Acts are in lieu of the taxes imposed on other corporations by section 230 of those Acts. By section 246 (b), paragraphs 1 and 2, Congress has defined "gross income" and "net income" of insurance companies subject to tax under that section as follows:

(1) The term "gross income" means the combined gross amount, earned during the taxable year, from in-

vestment income and from underwriting income as provided in this subdivision, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners;

(2) The term "net income" means the gross income as defined in paragraph (1) of this subdivision less the deductions allowed by section 247.

The succeeding paragraphs of section 246 (b) are devoted to the definition of various items entering into the computation of gross income as above defined. By section 246 (b), paragraphs 4 and 6, respectively, it is provided that:

(b) In the case of an insurance company subject to the tax imposed by this section—

(4) The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(6) The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

This definition of the term "losses incurred" on the part of Congress is strongly indicative of an intention on its part to use the term in a sense different from that in

which it is ordinarily used. Furthermore, a reference to the "Underwriting exhibit" (page 10) of the annual statement of fire insurance companies, convention edition, will disclose that "losses incurred" for the purposes of that statement are determined by the following computation:

14. Losses paid, per item 13, page 3, * * *

15. Deduct salvage and reinsurance recoverable December 31, 1922, per items (a) 28, page 4, * * *

16. Balance, * * *

17. Add salvage and reinsurance recoverable December 31, 1921, per item 15, of last year's exhibit, * * *

18. Total, * * *

19. Deduct unpaid losses December 31, 1921, per item 21 of last year's exhibit, * * *

20. Balance, * * *

21. Add unpaid losses December 31, 1922, per item 14, page 5, * * *

22. Losses incurred during 1922, * * *

It will be noted that this computation follows exactly the computation provided by Congress (sec. 246 (b) 6, *supra*) for determining "losses incurred" under section 246 (b) 4. It will also be noted that in item 21, *supra*, entitled "Unpaid losses December 31, 1922," item 14, page 5, of the annual statement is incorporated by reference. A reference to this item will disclose that it carries the total of "net unpaid claims" as of the close of the year and includes in that total the total of the two items "losses incurred but not reported" and "resisted losses."

It thus becomes apparent that "losses incurred but not reported" and "unpaid losses" are uniformly included un-

der the head of "unpaid losses" in determining the total "losses incurred" in a given year for the purpose of the annual statement of fire companies as submitted to the insurance commissioners of the various States.

It is fundamental that in construing a statute dealing with a particular trade or business it is to be presumed that terms used in such a statute are used in the sense that those terms are understood in the trade or business with respect to which the statute was enacted when such terms have a meaning in that trade or business different from the commonly accepted meaning. In view of this rule of statutory construction and the intention of Congress, apparent from a reading of those paragraphs of section 246 hereinbefore quoted, as well as the uniform treatment among fire insurance companies of the items in question as shown by the annual statements of such companies, this office is of the opinion that "losses incurred but not reported" and "resisted losses" should be included in the computation of "losses incurred" under section 246 (b) 4 of the Revenue Act of 1921 and the corresponding sections of subsequent Revenue Acts.

The effect of this construction of the term "losses incurred" as used in section 246 (b) 4 is to exclude the items in question from the gross income of fire insurance companies subject to tax under section 246. Therefore, to permit these items to be deducted under section 247 (a) 4 in ascertaining the net income of such companies would be to permit the same item to be deducted twice contrary to the prohibition of section 247 (c). It necessarily follows that "losses incurred but not reported" and "resisted losses" should not be allowed as deductions under section 247 (a) 4.